INTERIOR BOARD OF LAND APPEALS

Union Oil Company of California

158 IBLA 265 (February 21, 2003)

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UNION OIL COMPANY OF CALIFORNIA

IBLA 99-92 Decided February 21, 2003

Appeal from a decision of the Deputy State Director, Wyoming State Office, Bureau of Land Management, denying an application for a royalty rate reduction. WYC037867.

Affirmed.

1. Administrative Procedure: Collateral Estoppel: Generally–Collateral Estoppel

   Adjudication of a royalty rate reduction application is not barred by the principal of collateral estoppel, insofar as it concerns a royalty rate reduction application for a time period separate and distinct from an application that was the subject of earlier administrative and judicial litigation between the same parties concerning the same lease.

2. Mineral Leasing Act: Royalties–Oil and Gas Leases and Permits: Generally--Oil and Gas Leases and Permits: Royalties

   The authority conferred by 30 U.S.C. § 209 (2000), enables BLM to exercise discretionary authority to grant or deny an application for royalty rate reductions. In order to grant such a reduction, BLM must determine that either (i) the reduction is necessary to promote development, or (ii) the lease cannot be successfully operated without the reduction. Granting a royalty rate reduction under MLA section 39's "necessary to promote development" provision is appropriate if doing so would encourage the greatest ultimate recovery of oil and gas in the interest of conservation of natural resources, and if prudent business judgment indicates that the reduction would be in the interest of the United States.

3. Precedent and Authority: Bureau of Land Management–Internal Memoranda

   BLM Instruction Memoranda are not binding on the Interior Board of Land Appeals.

APPEARANCES: Carol J. Westmoreland, Sugar Land, Texas, and Charles A. Breer, Esq., Denver, Colorado, for appellant; Robert A. Bennett, Deputy State Director, Wyoming State Office, Cheyenne, Wyoming, for the Bureau of Land Management; Jay A. Jerde, Esq., for the State of Wyoming.

OPINION BY ADMINISTRATIVE JUDGE HEMMER

Union Oil Company of California (Union) appeals from an October 6, 1998, decision issued by the Wyoming State Office, Bureau of Land Management (BLM). The decision rejected Union's application for a royalty rate reduction on an existing oil and gas lease. The appeal challenges as erroneous BLM's conclusions that a royalty rate reduction for the relevant period was not "necessary to promote development" and that Union's use of off-lease fuel in its tertiary recovery operation was contrary to Instruction Memorandum No. (IM) 88-602 (Aug. 2, 1988), as amended by Change 1 (Oct. 3, 1988).

BACKGROUND

Section 39 of the Mineral Leasing Act (MLA) permits the Secretary of the Interior to allow royalty rate reductions on Federal oil and gas leases, in certain circumstances. It provides:

> The Secretary of [the] Interior, for the purpose of encouraging the greatest ultimate recovery of * * * oil * * *, and in the interest of conservation of natural resources, is authorized to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold * * * <u>whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein</u>.

30 U.S.C. § 209 (2000) (emphasis added).

The South Casper Creek Field in Natrona County, Wyoming, is located in one of the State's oldest producing oil and gas provinces. From 1960 until 1995, Union held federal oil and gas lease WYC037867 in the South Casper Creek Field, located in sec. 3, T. 33 N., R. 83 W., Sixth Principal Meridian. Union "enjoyed excellent production from the lease through the use of primary and secondary recovery techniques." (Feb. 16, 1999, Statement of Reasons (SOR) at 2). However, the high viscosity of the crude oil and the low pressure and temperature of the reserve made "mobility of oil * * * unfavorably low." (Union Ex. 1, attached Dec. 17, 1980, letter from Union to United States Geological Survey (USGS).) 1/ Accordingly, in 1980, Union notified USGS that it intended to conduct tertiary recovery by means of steam injection operations in an effort to increase the mobility of the crude oil, and thereby to "recover additional heavy oil reserves" from the Tensleep formation in the South Casper Creek Field. <u>Id.</u> at 2.

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1/ The USGS was the agency within Department of the Interior (DOI) then responsible for approving tertiary recovery operations.

In a subsequent application to the USGS regarding the steam injection operations, Union sought a royalty reduction credit. (Union Ex. 1, Apr. 24, 1981, letter from Union to USGS.) Union stated that it intended to fuel its steam generators with gas produced off-lease, instead of crude oil produced from the lease as permitted by Notice to Lessees (NTL) 4A, dated January 1, 1980. 2/ (Union Ex. 1, Apr. 24, 1981, letter from Union to USGS at 1-2.) Union contended that off-lease gas was critical to the steam generator project, because the low gravity and high-sulfur crude oil produced from the lease was unsuitable for use in steam generators. Id. Union asserted that the project would "maximize the rate and amount of oil recovery" from the lease and asked for "royalty elimination on a thermally equivalent amount of * * * crude oil" produced from the relevant oil formation to that which Union would have been entitled to if it had used lease-produced oil to fuel its steam generators. (SOR at 2; Apr. 24, 1981, letter from Union to USGS at 2-4.)

Union began steam enhancement operations in 1981. USGS formally approved Union's proposal as a request for royalty credit for alternative fuel on October 1, 1981. (Union Ex. 2, Oct. 1, 1981, letter from USGS to Union.)

Subsequently, the Department reconsidered the question whether a royalty credit was appropriate. In May 1985, the Chief, Royalty Compliance Division of the Minerals Management Service (MMS), requested that the MMS Royalty Valuation and Standards Division (RVSD) review USGS's approval of Union's "royalty credit for substitute fuel." (Union Ex. 3, June 23, 1986, memorandum from Chief, RVSD, to Wyoming State Director, BLM.) 3/ RVSD concluded that USGS lacked the authority to approve a "royalty credit" for the use of off-lease fuel, and requested BLM to concur and to advise Union of a rescission of the October 1, 1981, USGS approval. Id.

On August 2, 1988, BLM issued Instruction Memorandum (IM) 88-602, addressing "Royalty Rate Reductions for Financially Successful Oil and Gas Operations." IM 88-602 identified section 39 of the Mineral Leasing Act (MLA), 30 U.S.C. § 209 (2000), as the source of authority for royalty rate reductions and concluded, inter alia, that such reductions would be allowed for use of off-lease alternative fuel if a project operation is "currently using royalty-free fuel produced on-lease and [such fuel has been] utilized on-lease" for the last 3 years. (IM 88-602 at 2, Criteria 4.) On October 3, 1988, BLM amended IM 88-602, Criteria 4, issuing Change 1. This change required that, in order to approve a company's request for a royalty rate reduction, BLM must find that the project operation used lease-produced fuel for "at least 3 years during the life of the project."

BLM subsequently obtained a legal opinion with respect to USGS's 1981 decision approving Union's royalty credit. On November 2, 1988, the Assistant Solicitor for Onshore Minerals concluded that BLM had the discretionary authority to reduce royalties in the circumstances described by USGS, under MLA section 39. (Union Ex. 5, attached Nov. 2, 1988, memorandum from Assistant Solicitor to

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2/ NTL-4A provided that "[n]o royalty obligation shall accrue as to that produced oil which * * * is used on the same lease, same communitized tract, or same unitized participating area for beneficial purposes" including "for firing steam generators for the enhanced recovery of oil." (Union Ex. 1, attachment, NTL-4A at sections I and II.B.4.)

3/ MMS is the successor to USGS with respect to royalty collection activities.

Assistant Secretary, Land and Minerals Management.) The Assistant Solicitor appeared to agree with MMS that a "royalty credit" was not permitted under the MLA. He also acknowledged that IM 88-602, Change 1, would not permit the royalty rate reduction, but stated that its application to Union might be arbitrary given that the 1988 IM post-dated approval of the steam injection request by 7 years. Id. On November 22, 1988, the BLM Wyoming State Director forwarded this legal opinion to RVSD and stated that the 1981 USGS approval with respect to Union was correct insofar as it could be decided as a royalty rate reduction under section 39 of the MLA. (Union Ex. 5, Nov. 22, 1988, Memorandum from State Director to RVSD.) The State Director stated that the "purpose of the approval was to encourage the greatest ultimate recovery of oil and was in the interest of conservation of natural resources." Id.

Repeating this purpose, the BLM Wyoming State Director issued a decision to Union which concluded that the royalty credit should have been issued as a decision to permit royalty rate reduction. (Union Ex. 6, attached Dec. 8, 1988, letter from BLM to Union). BLM granted a royalty rate reduction effective from October 1, 1981, through December 1984, subject to annual reexamination, and stated that after such annual review BLM had the discretion to cancel the royalty rate reduction if the terms of the approval were not met or if it was in the interest of the United States to do so. Id.

On January 18, 1989, an incoming Wyoming State Director for BLM issued a second decision granting the royalty rate reduction to Union, effective October 1, 1981, through the termination date of January 17, 1985. 4/ (Union Ex. 6, attached Jan. 18, 1989, letter from Wyoming State Director, BLM, to Union.) The letter based its conclusion on the 1988 advice of the Assistant Solicitor described above. Id. 5/

The State of Wyoming, which receives 50 percent of Federal lease royalties, appealed the January 18, 1989, BLM decision to this Board. On January 24, 1991, the Board affirmed BLM's decision granting the royalty rate reduction to Union as necessary to promote development. State of Wyoming, 117 IBLA 316 (1991). Relying on BLM's discretionary authority, the majority opinion found that the State did not refute "the ultimate resource recovery and benefits of increased royalties to the Government." The majority stated that BLM evaluated Union's operations and concluded that the economic interest of the Federal lessor was served by Union's operations. Id. at 322. Thus, the majority concluded that it was "unable to find" error in BLM's conclusion that the reduction was "necessary to promote development," as described in MLA section 39.

The State of Wyoming sought judicial review of the Board's decision before the United States District Court for the District of Wyoming. The Federal court affirned the Board and BLM's decision.

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4/ Steam injection operations had been suspended in Jan. 1985. (Union Ex. 10, Affidavit of Randy J. Koliba, at 2.)

5/ On Jan. 4, 1989, BLM apparently vacated its Dec. 8, 1988 decision. See Mar. 18, 1999, Answer of the State of Wyoming (WY Answer) at 2; see also State of Wyoming, 117 IBLA 316, 318 (1991). This
vacatur decision does not appear in the record.

See State of Wyoming v. Lujan, No. 91-CV-0097-B, Order at 8-9 (D. Wyoming, Dec. 16, 1991). (Union Ex. 11.)

Union alleges that although enhanced oil recovery continued after it ceased steaming operations in 1985, the effectiveness of the recovery decreased as oil cooled over the years in the absence of pressure from the injected steam. (SOR at 4.) In support of this assertion, Union cites the Affidavit of Randy J. Koliba, Union's District Joint Venture Manager. (Union Ex. 10.) Instead, the Koliba affidavit states that:

> Although active steam injection operations were suspended in January 1985, enhanced production continues to date because oil within the Lease remains heated over that which prevailed prior to the conduct of those operations, and development drilling, as part of the steam flood project, has increased the number of producing wells.

Id., Koliba Affidavit ¶ 9.

Union decided to reactivate the steam operations and enhanced oil recovery in April 1988. On March 31, 1989, following BLM's 1989 decision authorizing royalty rate reduction for the lease for 1981-1985, Union submitted a second application to BLM requesting approval of a royalty rate reduction effective April 1, 1988, when Union had reactivated the project. (SOR at 4; Mar. 31, 1989, letter from Union to BLM.) In this letter, Union asserted that if "favorable response continues, the steaming project may be expanded in the future." Id. Union requested a royalty rate reduction "based on the formula" presented in BLM's initial December 8, 1988, letter approving the royalty rate reduction on an annual basis for the years 1981 through 1984. On April 21, 1989, BLM replied to Union stating that it would postpone making any decision on the second application, as the first application was still in litigation.

On June 9, 1992, BLM issued a decision rejecting Union's second application on the grounds that the reduction was not "necessary to promote development." (June 9, 1992, decision.) BLM stated that the distinction between the first application, which was granted, and the second, which BLM was denying, was based on the terms of Union's 1989 application:

> The intent of the prior RRR [royalty rate reduction] approval was to promote development and to encourage the greatest ultimate recovery of oil, which was in the interest of conservation of both oil and air quality. [Union] has been successful in halting the historical production decline on the lease with the pilot project steaming operations during 1981-1985. In their RRR application, [Union] submits that if the project is expanded in the future, incremental recoverable reserves will be greatly increased. [Union] also indicates that the lease is producing oil in paying quantities and has been since 1960. Based on the apparent success of the reduced scale steaming operations, it is determined that under Section 39 of the MLA, a RRR for subject lease is no longer necessary to promote development of the lease. The

> steaming operations have enhanced reserve recovery and any RRR for a financially successful oil and gas operation must meet the eligibility criteria outlined in IM No. 88-602 and IM No. 88-602, Change 1.
>
> In view of the foregoing, your March 31, 1989, request for a RRR for lease WYW037867 is denied. UNOCAL does not satisfy criteria No. 4 of IM No. 88-602, Change 1, nor is it determined that a RRR for the subject lease is necessary in order to promote development.

(Union Ex. 12, June 9, 1992, decision (emphasis in original).)

On July 9, 1992, BLM met with Union to discuss the rejection of Union's second application. As a result, BLM rescinded the June 9, 1992, decision to provide Union an opportunity to present additional information it contended would be relevant to consideration of the application. (Union Ex. 14, July 15, 1992, BLM decision.)

On February 14, 1996, Union submitted additional data and sought $966,651 in reduced royalties for the period from April 1988 through April 1993. (Union Ex. 17, Feb. 14, 1996, supplemental application from Union to BLM.) Union contended that the steam operation is "critical to maximize recovery in this field." Id. at 2. Union stated that the project was of a marginal economic nature, and that it "will never payout for [Union], with a $29 Million loss; but has been extremely beneficial for the BLM and the State of Wyoming with incremental royalties and taxes." Id. Union also pointed to a final rule published by BLM on February 8, 1996, regarding economic incentives for the production of heavy oil, effective March 11, 1996. 61 FR 4748 (Feb. 8, 1996). This rulemaking added provisions to existing rules governing royalty rate reductions at 43 CFR Part 3100, effective March 11, 1996.

On October 6, 1998, BLM issued a decision rejecting Union's application. (Union Ex. 20.) BLM concluded that it "believe[s] the determinations made in the June 9, 1992, decision were and are still valid as the minimum requirements for a RRR application as required by 43 CFR 3103.4-1 were not met." Id., Oct. 6, 1998, decision at 2. BLM discussed the application in light of 43 CFR 3103.4-1(b) and (c) and concluded that "it is not clear whether the steaming operations would have been conducted without the benefit of a RRR." (Oct. 6, 1998, decision at 2.) Citing exhibits attached to Union's 1996 supplemental information, BLM noted that "Exhibit E figures showing net cash flow and net operating revenues beginning in 1985 indicate that WYC037867 was operating economically (except 1991)." (Union Ex. 20, Oct. 6, 1998, decision at 2.) BLM stated that Union "has not provided sufficient information to indicate that lease operations without the steamflood project were ever in economic difficulty or that there were problems in resource recovery." Id. BLM concluded:

> Upon review of the March 31, 1989, application and supplemental information provided by [Union], we do not find that a RRR for WYC037867 is appropriate. The steaming operations do not qualify for a RRR under the eligibility criteria outlined in WO IM No. 88-602, (amended under WO IM No. 88-602, Change 1), nor is it

> determined that a RRR for WYC037867 is <u>necessary</u> in order to promote development. There is insufficient information to indicate WYC037867 was in economic difficulty or that there were any problems with resource recovery. Although it is recognized that steaming operations have been beneficial to maximize resource recovery from WYC038767, it is not clear whether steaming operations restarted in 1988 would have been conducted without the benefit of a RRR, or that there was a reasonable probability that lease operations would cease or c
> the resource would be jeopardized without the benefit of RRR.

(Oct. 6, 1998, decision at 3 (emphasis in original).)

Union timely appealed BLM's decision. The State of Wyoming participated by submitting an Answer in support of the BLM decision.

Union posits three central arguments challenging BLM's decision. 6/ Union asserts that (1) a royalty rate reduction for the 1988-1993 time period was necessary to promote development; (2) application of IM 88-602, Change 1, to Union, requiring the use of on-lease fuel for three years in order to qualify for a royalty rate reduction, is arbitrary given BLM's prior approval of Union's use of off-lease fuel for the 1981-1985 period; and (3) BLM is collaterally estopped from litigating these issues due to the prior decisions of IBLA and the District Court.

In response to Union's arguments, BLM denies that a royalty rate reduction was necessary to promote development during the relevant period, and insists that Union has not met the requirements of IM 88-602, Change 1, the agency's asserted policy governing royalty reductions for financially successful operations. (BLM Answer at 3.) BLM argues that the agency is not bound by the prior Board and judicial decisions pertaining to Union's earlier approved royalty rate reduction. The State of Wyoming reiterates and supports the arguments made by BLM in support of the agency's decision. (WY Answer.)

## DISCUSSION

[1] Because Union's collateral estoppel argument has the potential to moot any remaining arguments, we address that issue first. Under the doctrine of collateral estoppel, "once an issue is actually and necessarily litigated by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation."

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6/ Union claims in a footnote that BLM granted a royalty rate reduction in 1997 to its successor-in-interest on the lease, Mercury Exploration Company, and argues that such a decision cannot be squared with BLM's actions on Union's original 1981 application, and the denied 1988-1993 application. (SOR at 9 n.1; Union Ex. 19.) To the extent BLM granted a royalty rate reduction to Mercury Exploration Company, the record of that decision, its propriety, and the rules applicable after 1996 are not before us.

Montana v. United States, 440 U.S. 147, 153 (1979). For collateral estoppel to apply in this case, the issue of whether the royalty reduction is necessary to promote development on lease WYC037867 between 1988 and 1993 must have been actually litigated in the prior adjudication between Union, BLM, and the State of Wyoming. Id.

In State of Wyoming, 117 IBLA at 322, this Board held that BLM's finding that Union's tertiary recovery operations would best serve the economic interests of the government was not arbitrary, capricious, or unreasonable. The Federal District Court affirmed the Board's decision, finding that the
BLM's granting of a royalty reduction was not arbitrary or capricious. State of Wyoming v. Lujan, No. 91-CV-0097-B, Order at 9 (D. Wyoming, Dec. 16, 1991). To the extent the issue of necessity was considered in the administrative decision and judicial order, the finding of necessity was limited to and involved a review of data only for the time period from October 1981 to January 1985. Id.; 117 IBLA at 321-22.

The issue of necessity for the 1989 application involves production and revenue data submitted by Union for production years 1988 through 1993. The different production years covered by the 1981 and 1989 applications, the different position of the company with respect to steam flooding operations, and the different production revenue data pertinent to the respective applications distinguish the analysis of the issue for the two applications. Accordingly, we find that collateral estoppel does not preclude this litigation.

In a related argument, Union complains that BLM's change in position regarding Union's second application was not adequately explained, and thus was arbitrary, capricious and contrary to law. (SOR at 7-9.) Union contends that given its identical applications, the same lease and steaming operations, as well as the same statute and regulations, BLM had no justifiable reason to deny Union's second application. Id., citing FMC Wyoming Corp., 147 IBLA 51, 58-60 (1998).

In that case, BLM had granted an application submitted by FMC Wyoming Corporation (FMC) for royalty rate reduction in 1994, for tertiary recovery of sodium pillars and sodium in tailings ponds, finding that it would serve the economic interest of the government. In 1997 BLM partially rescinded the decision, concluding that the previous 1994 decision had not intended to include the portion of the sodium resource being recovered from mine tailings. Id. at 56. The Board reversed, finding on the record that FMC's application expressly addressed tailings ponds, and had stated that the tertiary recovery would permit recovery of sodium from tailings ponds that would otherwise be left in impoundments. Thus, the Board concluded that BLM's conclusion in 1997 that the 1994 decision had intended to separate two types of mineral product was contrary to the record of the 1994 decision. Id. at 60.

In FMC Wyoming Corp., BLM attempted to alter an existing royalty rate reduction without basis in the factual record for such action. There is no such amendment of an existing decision at issue here; rather, Union's original authorization expired. As a result, BLM was required to review Union's subsequent application and to take into consideration whether a second authorization of a royalty rate reduction for a different time period was "necessary to promote development" in light of then-existing

facts, and regulations at 43 CFR Part 3100. For these reasons, BLM's decision to review Union's second royalty rate reduction application as separate from its first application was not, in itself, arbitrary, capricious or contrary to law.

Moreover, Union argues, in effect, that once BLM exercised its discretion to grant a royalty rate reduction for its tertiary enhancement project during its initial phase, BLM was obligated to maintain that decision for any subsequent and future decision the company made with respect to restarting the project. We would not construe a BLM decision expressly limited to the 1981-85 period to have unintended consequences for the future. Nor would we construe the initial decision to bind BLM's discretion to apply past conclusions to all future company decisions irrespective of the circumstances. Yet, this would be the consequence of endorsing Union's argument that BLM was arbitrary and capricious for undertaking to review the facts of the new application.

We can understand Union's concern that its decision to halt operations in 1985 led to a change that might not have occurred if it had continued tertiary enhancement operations from 1981 through 1993. Nonetheless, BLM's 1989 approval of the royalty rate reduction for the first period was expressly limited to the period from 1981-85. We cannot speculate that BLM would have granted the reduction for a longer period, or how it would have structured its review of subsequent applications for royalty rate reduction had Union made a different decision with respect to its operations. Further, to the extent Union relies on the spirit of the subsequently applicable 1996 rules regarding heavy oil, those rules confirm that BLM is not bound to a first decision on a royalty rate reduction request; rather, those regulations expressly require annual, supplemental data and annual determinations by BLM. 43 CFR 3103.4-3(b)(iv) (1997). Accordingly, we find no arbitrariness in BLM's decision to review the 1989 application for the 1988-1993 period as a new application on new facts.

[2] Having rejected Union's arguments that BLM was estopped from considering the facts of the 1989 application, we turn to Union's substantive arguments. MLA section 39 provides that the Secretary may reduce the royalty on a Federal lease "whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein." 30 U.S.C. § 209 (2000). These statutory justifications for a royalty reduction are embodied in BLM regulations governing this discretionary exercise of authority. 43 CFR 3103.4-1(a) (1997). This rule provides that the Secretary may reduce royalties "upon a determination that it is necessary to promote development, or that the leases cannot be successfully operated under the terms provided therein * * *." Id. This Board, as well as the United States District Court for the District of Wyoming, cite the same statutory language in upholding BLM's exercise of discretion to allow a royalty reduction. E.g., FMC Wyoming Corp., 147 IBLA at 58-59; Wyoming v. Lujan, No. 91-CV-0097-B, Order at 7 (D. Wyoming, Dec. 16, 1991); see also State of Wyoming, 117 IBLA at 316.

Union acknowledges that it applied for a royalty rate reduction only under section 39's "necessary to promote development" provision. (SOR at 7.) In several cases addressing royalty rate reductions under this provision for oil and coal, the Board has explained the nature of the standard and

the Secretary's discretionary authority. In Western-Fuels Utah, Inc., 119 IBLA 231 (1991), the Board stated:

> Under the statute, a reduction of royalties and waiver of rentals must be for the purpose of encouraging the greatest ultimate recovery of Federal coal and in the interest of conservation of natural resources, and it must be based on one of two determinations: (1) that such relief is necessary to promote development, or (2) the Federal lease cannot be operated successfully under its existing terms. On the basis of the information submitted by the applicant, "BLM must be able to find there is a reasonable probability operations would cease or development, recovery, or conservation of the resource would be jeopardized before it can even consider exercising its discretion to grant relief." Peabody Coal Co., 93 IBLA 317, 327, 93 I.D. 394, 400 (1986). Additionally, "[t]he ultimate issue in the adjudication of any royalty reduction request is whether BLM may properly conclude, on the basis of the material submitted by an appellant, that granting a reduction would best serve the interests of the Government." Peabody Coal Co., supra at 321, 93 I.D. at 396; see also State of Wyoming, 117 IBLA 316, 321 (1991).

119 IBLA at 238.

Citing the same language, this Board more recently held in FMC Wyoming Corp.:

> In Peabody Coal Co., 93 IBLA 317, 321, 93 I.D. 394, 396 (1986), we stated that "[t]he ultimate issue in the adjudication of any royalty reduction request is whether BLM may properly conclude, the basis of material submitted by an appellant, that granting a reduction would best serve the interests of the Government." We held that 30 U.S.C. § 209 (1988), confers upon BLM
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> > [t]he discretionary authority * * * to exercise prudent business judgment to accept the alternative that best protects the economic interest of the United States as owner of the mineral resource. It necessarily follows that if the circumstances of a given case do not confront BLM with such a choice, the case presents no opportunity for BLM to exercise the discretion conferred by section 209. This conclusion is underscored by the fact that section 209 requires BLM to make one of two alternative threshold determinations before its discretionary authority can be invoked: (1) that a reduction "is necessary to promote development," or (2) "the leases cannot be successfully operated under the terms provided therein."

147 IBLA at 58-59, 93 IBLA at 326-27, 93 I.D. at 399-400 (footnote omitted). 7/ In Western Energy Co., 119 IBLA 359 (1991), we upheld BLM's denial of a royalty reduction for a coal lease under MLA section 39:

This Board has held that:

> [I]t would not be proper to reduce the royalty if the coal would ultimately be recovered and natural resources conserved in the absence of such a reduction. Unless an applicant shows that these goals cannot be met without a royalty reduction, the statute [30 U.S.C. § 209 (1988)] confers no authority on the Department to grant such a reduction. 119 IBLA at 365-66, quoting Peabody Coal Co., 93 IBLA at 328, 93 I.D. at 400.

Considering this precedent, we must determine whether BLM abused its discretion in concluding that Union's second application for a royalty rate reduction did not fulfill the standard of MLA section 39 that it be "necessary to promote development." 8/ In its decision denying Union's application, BLM found that Union failed to demonstrate that granting the application was necessary to promote development because Union had not shown that a royalty rate reduction was necessary for Union to implement tertiary enhancement recovery. (Oct. 6, 1998, decision at 3, citing Peabody Coal, 93 IBLA 317, 327-328 (1986) ("it would not be proper to reduce the royalty if the [oil] would ultimately be recovered and natural resources conserved in the absence of such a reduction").)

Considering the record and the material submitted by Union in support of its application, we do not find that BLM improperly exercised its discretion in denying the application. Indeed, according to its March 31, 1989, application for a second royalty rate reduction, Union restarted tertiary enhancement in April 1988. Thus, after stopping tertiary recovery efforts, Union began them again prior to a final decision even on Union's first application. While it was clearly in Union's financial and business interest to continue to litigate the first application, and the second, to resolution, Union's action makes clear that whether it achieved a positive result on a royalty rate reduction for any period of time was not determinative of its decision to restart the tertiary enhancement project using existing infrastructure. Further, Union's 1996 supplementation states that tertiary enhancement is necessary to
maximize production, but falls short of contending that royalty reduction was necessary to promote development in this case. Union argues that tertiary enhancement was necessary to "sustain

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7/ Considering the statutory language, the Board rejected as too restrictive a standard advocated by the State of Wyoming that a royalty reduction to promote development may be allowed only "when the development could not otherwise economically occur." State of Wyoming, 117 IBLA at 322.
8/ To the extent Union argues that BLM, the Board, and the District Court already decided this question under identical circumstances (SOR at 10), we have already found that, Union's second application is not controlled by a decision with respect to Union's first application for the 1981-1985 period.

incremental production rates," and that it established long term benefits to the United States. (Oct. 6, 1998, decision at 2.) The Secretary, by contrast, must find that the royalty rate reduction is necessary to promote development.

We find no error or abuse of discretion in BLM's construction of Union's supplemental documentation. 9/ In 1996, Union supplied exhibits to demonstrate the correlation between the steaming operations and an increase in lease production during 1988-1993. (SOR Ex. 17, Feb. 14, 1996, supplemental application, Exs. A and H.) BLM reviewed these documents and concluded:

> A review of Exhibit E indicates that, excluding the capital investment (normally not considered under 43 CFR 3103.4-1 if costs are not directly related to lease maintenance), net operating revenues have been essentially positive. The last column in Exhibit E shows only 4 years from 1973-1994 where the net operating revenue was negative. During the period of the RRR application (April, 1988 to April, 1993) only 1991 showed a loss.

(Oct. 6, 1998, decision at 2; see also 43 CFR 3103.4-1(b)(2-3).)

These documents do not compel BLM to exercise its discretion by granting the application. The documents show that, as BLM acknowledged, "it is recognized that steaming operations have been beneficial to maximize resource recovery from WYC038767." See Feb. 14, 1996, supplemental application, Exs. A-C. BLM is correct that Exhibit E shows a loss in 1991. However, it also shows a one-time cost of $1.3 million for "special well repair." (Ex. E at 1.) While Union suggests that the well repair is due to the project (Feb. 14, 1996, supplemental application at 2), it also states that Exhibits E-H show that "the project to date has required in excess of $40 Million capital investment and nearly $50 Million in increased operating and well repair expenses" including purchased gas, and, further, show that the project will result in a $29 million net loss. Exhibits G and H show that once this alleged cumulative loss was incurred for the lease and for the South Casper Creek Field, respectively, in 1980-1981, it remained a generally constant loss through 1993, notwithstanding positive loss/profit ratios in subsequent years. 10/ The additional production resulting from the first tertiary enhancement operations of 1981-1985, was never relevant to recovery of that loss, as Union conceded in 1996. Thus,

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9/ We recently held that BLM's exercise of discretionary authority must be supported by a rational and defensible basis which is set forth in the decision, or it will be found to be arbitrary and capricious. Martin S. and Joann Chattman, 154 IBLA 64, 69 (2000), citing Echo Bay Resort, 151 IBLA 277 (1999); Daniel T. Cooper, 150 IBLA 286, 291 (1999); Coalition for the High Rock/Black Rock Emigrant Trail, 147 IBLA 92, 95 (1998); Terry Kayser, 136 IBLA 148, 150 (1996); Four Corners Expeditions, 104 IBLA 122, 125-26 (1988).

10/ Some of Union's documents indicate that they relate to only the lease, and others to all of the South Casper Creek Field. See Exhibits A and H, referring only to the South Casper Creek Field. The significance of this to Union's financials is not clear.

the financial investment in tertiary enhancement was not ameliorated by the first royalty rate reduction for the lease. Considering these charts and Union's request for a total reduction of $966,651, for 1988-93, granting the requested royalty rate reduction for the years 1988 through 1993 (a) would not have resulted in a positive net operating revenue for 1991; (b) would not have been necessary for net
operating revenue to be positive during the other four years covered by the royalty rate reduction application, and (c) would not resolve the $30 million net loss reported from 1981 forward in Exhibits G and H.

Further, it is significant that at the time Union sought the second royalty rate reduction, the company contended that "enhanced production continues to date because oil within the lease remains heated over that which prevailed prior to the conduct of those operations" and the project "increased the number of producing wells." (Union Ex. 10, Koliba Affidavit, June 16, 1989, ¶9 (emphasis added).) 11/ Highlighting this affidavit is the fact that annual gross production from the lease between 1985 and 1987, when no steam injection operations occurred, remained significantly above the annual gross production in the years before steaming operations began in 1981. (Union Ex. 17,attached Ex. E.) Considering this contemporaneous evidence, it would not appear that BLM's conclusions were unreasonable.

Most importantly, Union has failed to show that the goals of recovery of the oil and conservation of natural resources would not have been met in the absence of such a reduction. Western Energy Co., 119 IBLA at 365-66, citing Peabody Coal Co., 93 IBLA at 328, 93 I.D. at 400. Nor has Union demonstrated that the requested royalty rate reduction, as opposed to tertiary enhancement, was "in the interest of the United States" such that BLM abused its discretion to deny it.

[3] Finally, BLM avers that Union's 1989 application sought a royalty reduction under BLM's Instruction Memorandum No. 88-602, as amended by IM No. 88-602, Change 1, and not under the "necessary to promote development" standard. BLM states that there is "no indication that the current application was submitted on the basis that it was necessary to promote development." (BLM Answer at 2.)

BLM is correct that the March 31, 1989, application did not identify the statutory language. (Mar. 31, 1989, application letter at 1-2.) However, IM 88-602, Change 1, was BLM's effort to identify requirements for statutory compliance for financially successful operations which chose to use off-lease fuel for tertiary enhancement operations, even as BLM stated in its June 8, 1992, decision, which was subsequently endorsed in BLM's October 6, 1998, decision on appeal. BLM clearly permitted Union to

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11/ The steam flood project for which the royalty rate reduction was permitted on lease WYC037867 was intended to lower the viscosity of oil in the Tensleep formation in the South Casper Creek Field. To the extent Koliba states that the project increased the number of producing wells, it is not clear whether these wells were located on the lease, or whether costs were allocated to off-lease production.

supplement its application in 1996, to attempt to meet this standard. Thus, we reject any suggestion that the application was inadequate in failing to cite the statutory language.

While these documents establish BLM's interpretation of MLA section 39's "necessary to promote development" provision, BLM Instruction Memoranda are not binding on this Board. See Western Fuels Utah, Inc., 119 IBLA 231, 239 (1991), citing Beard Oil Co., 105 IBLA 285, 288 (1988), Pamela S. Crocker-Davis, 94 IBLA 328, 332 (1986), United States v. Kaycee Bentonite Corp., 64 IBLA 183, 214, 89 I.D. 262, 279 (1982). Because our decision affirms BLM's decision to the extent that it found that granting Union's request for royalty rate reduction was not necessary to promote development, we need not address IM 88-602, Change 1, except to reject Union's argument that BLM was prohibited from considering subsequently announced policies for the 1988-1993 period that did not apply to the 1981-1985 period. 12/

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of BLM denying Union's 1989 royalty rate reduction application is affirmed.

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Lisa Hemmer
Administrative Judge

I concur:

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C. Randall Grant, Jr.
Administrative Judge

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12/ Indeed, the Assistant Solicitor's memorandum, described above, expressed the concern that it might be arbitrary to apply IM 88-602, issued in 1988, to the 1981-85 period predating its issuance. (Union Ex. 5, attached Nov. 2, 1988, memorandum from Assistant Solicitor to Assistant Secretary, Land and Minerals Management.) It does not follow that the agency is arbitrary for looking to agency manuals or policies applicable during a relevant period.